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Lessons from the Energy Community**

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Abstract¹

Over the last decades, a constant feature of the relations between the European Union (EU) and the countries in its neighbourhood has been the export of European law. Achieved through bilateral or multilateral agreements, the export of law has led to the 'juridification' of external policy. The energy sector is in the vanguard of this development. European energy law has been made applicable to third countries through the European Economic Area (EEA) and, most important for the European Neighbourhood Policy (ENP), the Energy Community. Bilateral agreements of relevance for energy include the (draft) Association Agreement with Ukraine which was rejected in November 2013 and came on the agenda again following a revolution in the country. Geopolitics has played and continues to play an eminent role in this respect. What does that mean for the export of European law to neighbouring countries? This paper argues that the export of European (energy) law does not only remain possible but is preferable to purely diplomatic relations between the EU and its neighbours if certain conditions are fulfilled. Based on the experience in the EEA and the Energy Community, multilateral integration agreements can be successful if they offer a well-designed institutional and procedural architecture based on mutual commitments, extend the benefits of the internal market to the participating third countries and create 'win-win' situations in satisfying also the participating third countries' vital interests in return for undergoing the hardship of economic reforms.

¹ This paper is based on a 'High-Level Lecture on the ENP in a Comparative Perspective', delivered at the College of Europe in Bruges on 5 March 2014. The author has written this paper in a personal capacity. Nothing in this paper can be attributed to the Energy Community Secretariat.

Prologue: Ukraine's rejection of the Association Agreement and its consequences

The recent events in Ukraine, undoubtedly the European Union's most prominent neighbour today, earned it the title of the "birthplace of Strategic Europe".² In any event, these events illustrate both the importance and the limits of the current European Neighbourhood Policy. The turbulent sequence of events unfolding since November 2013 began with protests and violence on Maidan square, which triggered the fall of the Yanukovich regime and in turn the annexation of Crimea by Russia. At the time of writing, the conflict continues in Eastern Ukraine. From the beginning, the Euro-Maidan revolution was embedded in a broader geopolitical context, namely Ukraine's orientation between the two powers on its eastern and western borders, Russia and the European Union. Ukraine has close historical, cultural and economic ties with both. 'Neighbourhood policy' for Ukraine has a slightly different meaning than it has for most of the EU Member States. The revolution in Ukraine was not only one against a corrupt government it was also about how to (re-)balance the relations with its two neighbours. The Association Agreement with the European Union, put up for signature at the Vilnius Summit in November 2013, was symbolic for this re-balancing. As far as the history of revolutions goes, the rejection of an international free trade agreement is a rather unusual trigger. While few people had probably read the agreement then, it symbolized something different for everybody involved.

For the people on Maidan square, the draft Association Agreement with the EU, rejected by Ukraine's *ancien régime*, epitomized what the preamble explicitly referred to as Ukraine's European choice. Little did the drafters know how the manifestations of the "strong public support in Ukraine for the country's European choice" would change the course of history.³

For the EU institutions, the Association Agreement with Ukraine⁴ is the most ambitious deal ever negotiated in terms of economic integration.⁵ It was meant to become a

² Jan Techau, Ukraine, the Birthplace of Strategic Europe, Carnegie Europe, 18 March 2014, <http://www.carnegieeurope.eu/strategieurope/?fa=55002>, retrieved 20 February 2014.

³ Quote taken from a recital in an earlier version of the draft Association Agreement.

⁴ The text of the Association Agreement (AA) is available at http://eeas.europa.eu/ukraine/assoagreement/assoagreement-2013_en.htm, retrieved 20 February 2014.

⁵ Karel de Gucht, EU-Ukraine trade negotiations: a pathway to prosperity, Speech delivered at the INTA Committee Workshop, Brussels, 20 October 2011, http://europa.eu/rapid/press-release_SPEECH-11-692_en.htm?locale=en. The Association Agreement is to replace the present Partnership and Cooperation Agreement which dates back to 1998.

historic milestone in the evolution of the European Neighbourhood Policy and the Eastern Partnership. The conclusion of bilateral agreements with neighbouring countries is the essence of the European Neighbourhood Policy. The Association Agreement with Ukraine envisages a “political association” in the form of a political dialogue⁶ and complemented by cooperation in the areas of justice, freedom and security.⁷ The political provisions of the Agreement were eventually signed by the EU, its Member States and Ukraine on 21 March 2014. The Agreement’s most substantial part, however, not yet signed at the time of writing, is trade-related. The draft for a so-called “Deep and Comprehensive Free Trade Area” is largely modeled on the WTO Agreement. It provides for the elimination of customs duties for certain goods⁸ and requires Ukraine to gradually approximate its legislation to EU standards and law⁹ in an “exceptionally broad”¹⁰ range of areas such as public procurement,¹¹ transparency, environment, protection of intellectual property, etc.¹² In terms of enforcement it envisages an elaborate arbitration procedure.¹³

We can only speculate about what the Association Agreement offered to Ukraine meant from the perspective of the Russian government. A basic lesson learned from November 2013, however, is that third countries with strategic interests in the Union’s neighbours will scrutinize any offer made by the European Union and may react with a counter-proposal, among other things. Russia also champions a Eurasian Economic Community (the framework for the so-called Customs Union), which borrowed some key features and institutions from the EU itself, and membership in which was offered to Ukraine. As alternative options exist, the European Neighbourhood Policy is no longer a bilateral affair.¹⁴ The neighbours of our neighbours matter. After Ukraine, the European Neighbourhood Policy turns into a comparison of systems. In times of globalization this is quite evident anyway. Possible alternative options are not limited

⁶ Title II AA.

⁷ Title III AA.

⁸ Article 29 AA. The European Union unilaterally abolished customs duties on 21 March 2014.

⁹ Article 474 AA.

¹⁰ Karel de Gucht, *op.cit.*

¹¹ Articles 148 *et seq.* AA.

¹² Articles 157-252 AA.

¹³ Which the Agreement describes in great details, Articles 306 *et seq.* AA.

¹⁴ Sensitivity about the interdependence of the European Neighbourhood Policy was maybe not always high in the past. In a document entitled “Myths about the EU-Ukrainian Association Agreement – Setting the facts straight” (<http://trade.ec.europa.eu/doclib/html/152074.htm>, retrieved 20 February 2014), one could read: “Of course, if Russia decided to retaliate [economically], there would be negative short-term consequences for Ukraine’s exports, but this would be a policy choice made in Moscow and cannot be attributed to the Agreement.”

to an association with Russia or its Customs Union. They may include policy choices such as maintaining the status quo under a paternalistic regime, selling-out to foreign investors with a strategic agenda or even succumbing to the allure of religious fanaticism, as could be observed in the wake of the 'Arab Spring'. We may have to accept further that in the aftermath of the Eurozone crisis, Europe has lost its former allure of a 'promised land', for which a neighbouring country will happily and without hesitation pay the entrance fee in the form of taking over EU rules.

The Yanukovich government, finally, must have compared the draft Association Agreement with the proposals made by Moscow. The Russian offer – as far as it is known – included a purchase of Ukrainian bonds of \$ 15 bn as well as a discount which brought down the gas price to \$ 268.5 per 1,000 m³.¹⁵ That offer was accepted and the European Union would have been out of the game if the Ukrainian people had not interfered with the Union's flag in their hands. Obviously, the Union cannot always count on revolutions inspired by a romantic affection for Europe in its handling of foreign affairs. Other examples in Eastern Partnership countries – Belarus, Armenia and Azerbaijan – demonstrate that. Usually the government and its parliamentary majority will decide whether an agreement offered by the European Union matches the country's interest. The Yanukovich government had evidently answered that question in the negative.

While the Association Agreement would have failed if it had not been for the protesters on Maidan, Ukraine is and has been a party to another agreement based on EU rules throughout all crises. In 2011 Ukraine had acceded to the Treaty establishing the Energy Community. The country even accepted preconditions by adopting a gas law following European rules, and has been implementing the *acquis communautaire* at least to some degree ever since. To be sure, President Yanukovich himself several times announced a withdrawal from the Treaty and it cannot be excluded that Ukraine's membership in the Energy Community was at stake in the negotiations with Moscow. Nevertheless, Ukraine's membership

¹⁵ As of 1 April 2014, the discount was withdrawn. Moreover, the price rebate granted in 2010 in return for the extension of the lease on the Black Sea Fleet's naval base on Crimea was subsequently cancelled. Naftogaz of Ukraine now pays 485 \$ per 1,000 bcm. The price for Belarus, a member of the Customs Union, is 165 \$ per 1,000 bcm.

remained continuity.¹⁶ The new government made implementation of the Energy Community rules an explicit priority.¹⁷ On the European side, Ukraine's membership in the Energy Community receives unfettered support from Member States and institutions alike. In a resolution on the situation in Ukraine in early February 2014, for instance, the European Parliament considered that "further efforts should be made to include Ukraine in the EU's energy market via the Energy Community".¹⁸

The commitments made in the framework of the Energy Community in some respects go even further than the proposed Association Agreement. The Energy Community is based on the export of the entire European internal market governance model (for energy), which includes fundamental principles such as unbundling, the right to third-party access and market opening. The Energy Community explicitly aims to integrate Ukraine's energy sector in Europe's internal energy market. That this is relevant for Ukraine is beyond doubt. The energy sector is of crucial importance for the country's economy, which heavily depends on Russian gas supply and transit fees. It is in the energy sector that the question of integrating with Russia or the European Union matters most for Ukraine. It is an interesting question why Ukraine kept its allegiance with the Energy Community – and thus EU energy rules – while it withdrew from the Association Agreement in exchange for, *inter alia*, a rebate in the gas price. It appears as if certain aspects of membership in the Energy Community are attractive enough to third countries to continue sector reform the sector. The experience made with the Energy Community may thus be relevant for answering the question of how agreements concluded with the Union's neighbours can be based on EU rules and still be fair and attractive to them, even under difficult geopolitical circumstances, as in Ukraine's case.

¹⁶ On 7 February 2014, at the height of the protests on Maidan, Ukraine and the Energy Community Secretariat even signed a memorandum establishing an "Implementation Partnership", an instrument meant to speed up the harmonization of the country's legislation with the *acquis communautaire*. See http://www.energy-community.org/portal/page/portal/ENC_HOME/NEWS/News_Details?p_new_id=8601, retrieved 20 February 2014.

¹⁷ http://www.energy-community.org/portal/page/portal/ENC_HOME/NEWS/News_Details?p_new_id=8782, retrieved 20 February 2014. On the EU side, the European Parliament demands "further efforts [...] to include Ukraine in the EU's energy market via the Energy Community". See European Parliament Resolution No 19 of 6 February 2014 on the situation in Ukraine (2014/2547(RSP)).

¹⁸ Resolution adopted in Plenary on 6 February 2014 in Strasbourg.

The export of EU law to neighbouring countries

The European Union over the last decades engaged in a strategy of exporting its rules to its neighbours.¹⁹ Law export, or “legal transplants”, has a long history inside and outside Europe,²⁰ including the reception of Roman law or the propagation of the Code Napoleon. While countries in transition have always looked for inspiration in more advanced jurisdictions, it is also in the interest of the ‘exporter’ to have the normative framework in other countries modeled on its own rules. The export of European law to neighbouring countries can be and actually is organized in different ways. The focus of this paper is on law export through the conclusion of international agreements. In this respect, we will distinguish between bilateral and multilateral export agreements.

The European Neighbourhood Policy as well as its related organizations, the Eastern Partnership or the Union for the Mediterranean, is multilateral in nature but does not directly export legally binding rules. These arrangements rather provide a policy framework for the conclusion of bilateral agreements aimed at the approximation with EU rules.²¹ The bilateral path to European law export has become increasingly cumbersome recently. Ukraine is only the most spectacular case in point. With Russia, the negotiations for a new Partnership Agreement have been in a deadlock for a long time. But we do not even have to look that far to the East: the bilateral relations between the European Union and Switzerland, based on a bundle of bilateral agreements, had turned complicated even before the recent referendum on mass-immigration. Both sides find it difficult to agree on the scope of substantive EU rules to be taken over by Switzerland (and the terms for an energy agreement are under negotiation already for several years). And it seems to be all but impossible to agree on the institutional arrangements necessary to move from abstract commitments to real implementation.

Multilateral agreements are better suited to avoid these pitfalls. Not only can they be a vehicle to export European law to more than one country at the same time. Once negotiated and signed, they also establish a model which third countries find easier

¹⁹ Stephan Renner, “The Energy Community of Southeast Europe: A neo-functionalist project of regional integration”, *EIoP*, vol. 13, 2009, p. 4.

²⁰ See, for an overview, Michele Graziadei, “Legal Transplants and the Frontiers of Legal Knowledge”, *Theoretical Inquiries in Law*, vol. 10, 2009, pp. 693-714.

²¹ See, for instance, Sandra Lavenex, “Concentric circles of flexible ‘EUropean’ integration: A typology of EU external governance relations”, *Comparative European Politics*, vol. 9, 2011, pp. 383 ff.

to join. Most importantly, they establish a more complex balance of power and open possibilities for alliances, whereas a bilateral partnership is almost inevitably dominated by the more potent partner. Multilateral agreements also justify the creation of independent institutions which seems almost impossible to achieve in a bilateral relationship. The advantages of multilateral agreements over bilateral ones are thus not only of a quantitative but also of a qualitative nature.

A comprehensive multilateral legal framework for the European Neighbourhood Policy does not exist. There seems to be no follow-up on the idea to create a "Neighbourhood Economic Community".²² However, there are two existing models for multilateral integration agreements between the European Union and neighbouring countries. One engages in comprehensive and the other one in sectoral internal market export. They are the EEA for three EFTA States, and the Energy Community covering – besides a number of accession countries in South Eastern Europe – the ENP States Moldova and Ukraine, and soon Georgia.

The EEA Agreement

Already at the outset of the ENP in 2003, the European Commission proclaimed that the policy's long-term goal was "to move towards an arrangement whereby the Union's relations with the neighbouring countries ultimately resemble the close political and economic links currently enjoyed with the European Economic Area."²³

The EEA Agreement entered into force in 1994. It was conceived and negotiated in the early 1990s upon an initiative by Jacques Delors. Its main objective is to unite the markets of the EU and of the participating EFTA States (today: Iceland, Liechtenstein and Norway, but at the time still a more considerable part of Western Europe) in one common internal market. The Agreement grants EU and EFTA States reciprocal access to their markets. In order to create the necessary level-playing field in the EFTA countries, they commit to take over the bulk of the *acquis communautaire*.²⁴ As concerns institutions, the Agreement creates joint bodies of which the EEA Joint Committee is of greatest practical importance. It incorporates EU law into the EEA on

²² See Sieglinde Gstöhl, "A Neighbourhood Economic Community – *finalité économique* for the ENP?", *EU Diplomacy Papers*, 3/2008, Bruges, College of Europe.

²³ Commission Communication "Wider Europe — Neighbourhood: A New Framework for Relations with our Eastern and Southern Neighbours", COM(2003) 104 final.

²⁴ With certain exceptions, namely the Common Agriculture and Fisheries Policies; Customs Union; Common Trade Policy; Common Foreign and Security Policy; Justice and Home Affairs and the Monetary Union. The EFTA country Switzerland has not joined the EEA Agreement.

an ongoing basis. Decisions are taken by its members – the representatives of the EFTA States as well as the European External Action Service – by consensus. Besides, the EFTA/EEA States also established administrative and judicial institutions within their pillar of the EEA Agreement, namely the EFTA Surveillance Authority and the EFTA Court.²⁵ They replicate the respective authorities in the EU pillar, the Commission and the Court of Justice. They watch over implementation and interpret the terms of EEA law, that is, exported EU law. To avoid deviations, the tie binding both pillars together is the homogeneity principle. This principle can be considered the ‘holy grail’ of the EEA Agreement. It guides legislative decisions, that is, the incorporation of new EU legislation by the EEA Joint Committee. But its greatest relevance is for judicial decision-making at the EFTA Court, with the EU Court of Justice’s jurisprudence as the point of reference.²⁶

The EEA works smoothly. As much as to a well-designed institutional architecture this is owed to the fact that the ‘legal and cultural DNA’ of the participating EFTA States is very similar to that of the EU-15. Iceland and Norway are Nordic countries closely tied to EU Member States Denmark and Sweden, whereas Liechtenstein’s political and legal traditions are shared between Austria and Switzerland. As homogeneous this renders the EEA in structural terms, it is difficult to conceive its enlargement by countries acceding from outside this Northern and Western circles, in other words European Neighbourhood Policy partners.

The Energy Community

The Energy Community, by contrast, is geographically much closer to, and partly overlaps with the European Neighbourhood Policy area. It currently covers five Contracting Parties from former Yugoslavia, as well as Albania, and two former republics of the Soviet Union, Moldova and Ukraine. Like the EEA Agreement, the Energy Community is a vehicle to export EU rules to participating third countries. As the name suggests, the Energy Community is sectoral in nature²⁷ even though it includes certain horizontal provisions such as environment, competition and state aid.

²⁵ The idea to establish a joint EEA Court proved legally impossible following the EU Court of Justice’s Opinion 1/91.

²⁶ Due to sovereignty reasons, judicial homogeneity is subject to a sophisticated distinction between the following by the EFTA Court of the EU Court of Justice’s pre-agreement case law and the mere “taking due account” of its post-agreement case law.

²⁷ Covering the electricity, gas and oil sectors.

Instead of the two pillars of the EEA, the Energy Community is structured in three layers. Besides the export of EU law to Contracting Parties under the first layer,²⁸ the Treaty establishes the possibility for setting genuine regional rules (including for neighbouring EU Member States) as well as for the energy markets of the EU-28 plus the eight Contracting Parties. These two layers²⁹ are missing in the EEA Agreement. In this respect, the Energy Community deliberately deviates from the concept of two pillars tied together by strict homogeneity. It gives the Energy Community a potential for the development of a legal framework for pan-European energy policy which goes beyond the simple mechanism of exporting law. In practice, however, this potential has rarely been used. The European Union put internal safeguards in place which are meant to ensure that Energy Community law does not bypass or overtake EU law.³⁰ This can be considered as a unilateral insistence on homogeneity and on letting the EU institutions take center stage. In the Energy Community Treaty, this is ensured through giving the Commission the exclusive right to propose new EU *acquis* for incorporation, as well as veto rights for the Union in decision-making under the more sensitive second and third layers.

Institutionally, the model chosen by the Energy Community Treaty is one of only joint, not parallel institutions. That is why the homogeneity principle, even though enshrined in the Treaty,³¹ features less prominently than in the EEA Agreement. Unlike in the EEA, the joint institutions are either independent of the Community's members (namely the Secretariat) or take decisions in accordance with the supranational majority principle (the Ministerial Council, the Permanent High Level Group and the Regulatory Board). In the decision-making process, all parties represented dispose of one vote without any weighing according to size. That means that any Contracting Party in principle has the same voting power as the entire European Union.

The weakest feature of the Treaty is enforcement: instead of establishing a surveillance authority with competences comparable to the Commission or the EFTA Surveillance Authority, the only instrument available to enforce compliance is an infringement action procedure initiated and carried out by the Secretariat. Instead of leading to a judicial body for decision, the ultimate decision-maker is the

²⁸ Title II of the Treaty.

²⁹ Titles III and IV of the Energy Community Treaty.

³⁰ Decision 500/2006/EC.

³¹ Article 94 of the Energy Community Treaty.

Ministerial Council, a non-independent and non-expert institution. Deterring sanctions are also missing.³²

The Energy Community was originally conceived somewhat more technically than the EEA, namely to prepare the countries in post-war South Eastern Europe for EU accession, and to push for the reforms necessary to attract investments in the energy sector. Over the last years, however, the Energy Community has evolved into the European Union's principal strategic instrument to organize its external energy relations. Ukraine's accession in 2011 was a milestone in this respect. Georgia, another strategically important country, is currently negotiating for accession.³³ The Energy Community has gained an unexpected vitality and attractiveness to ENP countries. To further increase the Energy Community's attractiveness to third countries and to rectify some of the institutional shortcomings such as weak enforcement, a High Level Reflection Group under the chairmanship of Jerzy Buzek is currently developing proposals for reform of the Energy Community. It aims to make the Energy Community fit for its new policy role in which it found itself almost by accident, and not necessarily well-prepared.

Which European model to be exported?

Both the EEA and the Energy Community, despite their differences in character and design, have proved to be successful in bringing countries in the neighbourhood (not limited to ENP countries in the technical sense) under EU rules. The multilateral approach corresponds best to the EU's own history and experience. In the case of the Energy Community, for instance, the European Coal and Steel Community was an explicit point of reference.³⁴ The successes of the EEA and the Energy Community imply that the EU can play its strengths and experiences best by not only creating but also participating, as a member, in a multilateral agreement which is modeled on its own governance scheme to a more or lesser extent. Multilateral integration in this sense is a true European value and an asset in the relations with third countries. To be a good basis for a fair and attractive offer it should contain the following elements:

³² Articles 90-93 of the Energy Community Treaty.

³³ Others, however, such as Turkey, have never joined for political reasons, even though the mutual benefit would be high.

³⁴ Renner, *op.cit.*, p. 8.

Integrating in a joint internal market

The European Union's historic achievement is the integration of economies and its beneficial impact on peace and stability. Integration of markets is at antipodes with diplomatic deal-making and the use of energy as a political weapon. The main tool to promote integration in Europe is the internal market, the European Union's flagship instrument to this day. The internal market is the sum of its parts and even more. Consequently, export of European law should not be limited to the export of individual pieces of legislation or norms. What is required is the "externalization of the internal market".³⁵ The export of the internal market in its entirety requires sharing it. This may work also in one sector, as the example of the Energy Community shows, and even if the sector is of high geopolitical and social sensitivity.³⁶

In energy, integration of markets has very concrete benefits for its participants. In the Contracting Parties to the Energy Community, membership has brought about clear and tangible integration benefits. This is particularly true for Ukraine. In the electricity sector, the country benefits from the free movement of goods which helps its companies' export activities. In the gas sector, the diversification of gas supplies is made possible by reverse flows of gas through the pipelines entering the EU in Hungary and Poland. The introduction of that kind of gas-to-gas competition has effectively decreased Gazprom's leverage over the country in the past, and is likely to play an important role again in the preparations for next winter's security of supply. Overcoming the remaining obstacles to reverse flows using the (larger) capacities at the Ukrainian-Slovakian border³⁷ may require applying the Energy Community rules (sector-specific energy law and competition law) vigorously to the contracts concluded between Gazprom and Naftogaz of Ukraine. In any event, the abstract concept of market integration based on the rule of law materializes in very concrete benefits in this case.

³⁵ Sieglinde Gstöhl, "Political Dimensions of an Externalization of the EU's Internal Market", *EU Diplomacy Papers*, 3/2007, Bruges, College of Europe, p. 4.

³⁶ For sure, sectoral internal market export can be made more potent if certain horizontal elements which proved to be very effective in the history of European integration, such as competition and state aid enforcement or public procurement law are included.

³⁷ For details on the options as well as the remaining obstacles, see Georg Zachmann/Dmytro Naumenko, "Evaluating the options to diversify gas supply in Ukraine", *German Advisory Group Policy Paper Series*, PP/01/2014, February 2014. On 28 April 2014, a Memorandum of Understanding enabling reverse flows from Slovakia to Ukraine was eventually signed. The relevance of Ukraine's membership in the Energy Community for this success was highlighted in the Commission's press release, http://europa.eu/rapid/press-release_IP-14-487_en.htm

Legally binding commitments and their implementation

Europe in the 1950s chose to integrate national economies through the harmonization of legal rules. As regards external policy, the focus on rules and market governance rather than following more political approaches has been criticized.³⁸ Experience shows, however, that binding commitments matter. Looser or softer cooperation arrangements tend to come to a point where giving the respective partner country an agenda for political and economic reform, supported by capacity-building, knowledge-transfer or technical assistance, is not enough to overcome certain domestic obstacles which frequently take the form of norms.

An agreement based on binding legal rules can be expected to be more transparent, neutral and fair than a political one. Based on the expectation of implementation in the domestic legal orders, legal commitments also serve as clear targets aimed at changing domestic legal frameworks epitomizing structural rigidities. The implementation success can be monitored, which in turn is a precondition for any corrective action. Measuring compliance or non-compliance of a country such as Ukraine in the past proved also very helpful to build up pressure from civil society, investors or external donors, often a precondition for real change to happen inside a country.

Such indirect enforcement is obviously not sufficient in itself to turn abstract commitments into reforms. To be credible, enforcement of rules in an integration agreement requires judicial decision-making replacing diplomatic dispute resolution.³⁹ This is also called for by the standards of the European Convention on Human Rights with regard to access to justice.⁴⁰ The EEA Agreement is clearly superior to the Energy Community Treaty in this respect.

Moreover, an element of public enforcement is indispensable when following the European integration model. Relying on enforcement based solely on private, subjective interest – which in the area of international energy relations usually takes the form of arbitration – is indispensable, especially in certain countries in the

³⁸ See Arianna Checchi/Arno Behrens/Christian Egenhofer, "Long-Term Energy Security Risks for Europe", *CEPS Working Document*, no. 309, Brussels, January 2009, p. 40.

³⁹ For more details Dirk Buschle, "The Enforcement of Energy Law in Wider Europe", in Buschle/Hirsbrunner/Kaddous (eds.), *European Energy Law*, Basel: Helbing & Lichtenhahn, 2011, pp. 303-342.

⁴⁰ See the judgment of the European Court of Human Rights in case *Bosphorus vs Ireland* of 30 June 2000.

European neighbourhood. Opening a path to arbitration in the energy sectors is the main benefit of the Energy Charter Treaty. The Deep and Comprehensive Free Trade Area follows the same approach.⁴¹

But arbitration has two major shortcomings: First, without a public authority systematizing and prioritizing cases, enforcement takes place only randomly. To give an example, in the Energy Community a disproportionate number of the complaints raised by private investors relates to the lack of cost-reflectivity of energy tariffs. While this is an important issue indeed, investors do normally not complain about many other important issues, such as energy efficiency or the lack of market opening. Without enforcement initiated by an independent public authority, non-implementation of the majority of commitments made by Contracting Parties would remain unsanctioned.

Second, an arbitration procedure is costly and lengthy. It may be affordable to big international investors, but small and medium enterprises, domestic companies or consumers will often shy the costs and rather choose to stay outside risky markets if arbitration is the only mitigating factor they can rely upon. It is those players, however, which can and should benefit most from market integration. Arbitration thus cannot replace a judicial institution granting access to justice for citizens and business, as a true public service, and not only to those who can afford it.

The importance of institutions

European integration history further teaches us that Monnet's concept of perpetuating and further developing the level of integration by creating institutions is a key success factor. If the ENP idea is indeed "sharing everything but institutions"⁴² the concept is flawed. Institutions can reinforce and balance the interests of the members of the respective organization (Ministerial Councils or Joint Committees). More importantly, they can defend the interest of the organization itself, private persons and economic operators against the state. In the latter case, institutions need to be truly independent. In an agreement extending the internal market

⁴¹ The arbitration procedure envisaged under the provisions of the Deep and Comprehensive Free Trade Area create a special regime for energy matters, namely an explicit fast-track procedure for energy supply disruptions, Articles 307(8), 308(4), 309 and 310(3) of the draft AA, and special retaliation measures in the form of suspension of rights arising from the Free Trade Area, Article 314 of the draft AA.

⁴² Romano Prodi, "A Wider Europe – A Proximity Policy as the Key to Stability", Speech02/619 given in Brussels on 5 December 2002.

governance and rules, independence of institutions is not necessarily a threat to the ownership of the EU institutions over their own rules. Applying an intelligent homogeneity principle as in the EEA helps overcoming such concerns. When designing an institutional architecture for an integration agreement, the EU model based on elements such as equal treatment, rule of law, independence and majority-ruling is and should be the standard. Extending it together with the relevant rules on substance is a matter of fairness. The fact that the Energy Community, for instance, allows third countries to discuss and vote on equal terms with the European Union partly explains its attractiveness.

Satisfying the interests of law-importing countries

According to this author's view and experience, *integration* through expanding the internal market, effective *implementation* of binding commitments and functioning *institutions* are the three basic elements for a good design of European law export. As much as the design matters, however, it will not suffice to ensure the success of this export in the long run. Implementing European rules, if taken seriously, constitutes a major effort for any rule-importing country. As the experience in the Energy Community, and in particular the recent events in Ukrainian show, implementation needs to satisfy genuine interests not only at the time of signature but on an ongoing basis. This is often forgotten in an organization as stable and perpetual as the EU itself.⁴³ The European Union's basic interest in exporting its own rules can probably be taken for granted.⁴⁴ The discussions inside the Union rather revolve around the question of which – political, economic or financial – price we are ready to pay. But for third countries, changing the governance in one or more economic sectors by aligning it with the European model, requires a strong motivation. In the following, a few recurring motives will be discussed.

Reform for the sake of increasing efficiency

"Our offer is easier", the Economist recently quoted a European Minister. "Our condition is that Ukraine should start fixing its economy. Russia's condition is that Ukraine should become a vassal."⁴⁵ Fixing the economy by applying European rules

⁴³ Recently, however, Member States such as the United Kingdom openly discuss their interests in adhering to the European Union.

⁴⁴ Sieglinde Gstöhl, "Political Dimensions of an Externalization of the EU's Internal Market", *EU Diplomacy Papers* 3/2007, p. 6.

⁴⁵ *The Economist*, "Charlemagne – Keep the door open", 8 February 2014.

is more easily said than done, especially in the energy sector with so many vested interests in maintaining the status quo. Yet taking on European rules as the best available software for market reforms and integration remains the ideal motive for joining the internal market. Obviously, the European reform 'software' may have its bugs as well.⁴⁶ But it is state of the art for organizing basic reforms of inefficiently run sectors. Countries may, for instance, realize that their power utilities are on the verge of bankruptcy because they must sell at artificially low prices to their customers. Or, that huge gains in terms of sustainability and security of supply can be made by saving energy in a smart way. If a country looks for a template for good governance, it has an interest in joining the Energy Community or the EEA. In the given political situations in many neighbouring countries relying on this motive might sound naïve. Yet the rationale of increasing efficiency of the energy sector can play an important role in a bundle of motives, and can even be dominant. The energy systems of the EEA member Iceland or the future Energy Community member Georgia are both not interconnected to any neighbouring country under EU rule. Despite their geographical isolation, both countries apply the *acquis communautaire* out of a belief in the healthiness of reforms and find the EU's rules on unbundling, third-party access and independent regulatory authorities helpful.

Countries which are or can be interconnected among themselves and Member States have an additional incentive in applying European rules as an instrument and driver for the integration of (regional) markets. According to economic theory, the integration of markets can increase allocative efficiency by enabling economies of scale and widening consumer choice. This is confirmed in practice by investors having little appetite to enter small markets. In the energy sector, the benefits to be reaped are particularly high because the cross-border allocation of factors such as different fuel mixes and production costs can be organized more efficiently than within the confinements of one small country. In practice, however, false dreams of energy autarchy often prevent countries from effectively coupling their markets on a regional level. Yet market integration remains interesting not only for the once integrated countries of South Eastern Europe but could also be an argument for the electricity systems in Northern Africa or the Caspian region in the future. Switzerland,

⁴⁶ Taking the internal energy market as an example, a discussion has started about the appropriate balance between the sustainability goal and various forms of state intervention. See European Commission, Communication from the European Commission "Delivering the internal electricity market and making the most of public intervention", Brussels, 5 November 2013, C(2013) 7243 final.

a country with a high degree of technical integration with the EU market, could particularly profit also from legal integration under a governance scheme such as the one of the Energy Community.

The experience in the current Contracting Parties to the Energy Community shows, however, that the 'one-size-fits-all' approach to the export of EU rules may have to be reconsidered at least in part, in order to enhance their capacity to effectively reform markets which differ from those in Western Europe as regards their historical, geographical and social conditions. Insisting on the adoption of EU law in a uniform manner admittedly ensures homogeneity within the enlarged internal market created between the EU and third countries. But homogeneity should not turn into a straightjacket. Certain elements of the energy *acquis communautaire* such as retail market opening, or supporting renewable energies in the same way certain Western countries have done in the past, may, and have already, put Eastern and South Eastern countries under stress. The issue is complex as, on the other hand, the practice of setting energy prices at a too low level for social reasons lies at the bottom of serious inefficiencies of the energy systems. Balancing liberalization and social stability is not a simple task. This challenge calls neither for less nor for different rules as the EU's rules, but for rules adapted to the specific needs of the law-importing countries in a smarter way. Law export requires a certain degree of flexibility and creativity in shaping EU rules. Flexibility in this context has several dimensions. It may require *ad hoc* adaptations of the *acquis* for individual countries,⁴⁷ or a 'variable geometry' among the participating third countries based on a differentiated set of rules with a common minimum, or even the adoption of *sui generis* rules for the pan-European internal market. This was envisaged but never practiced under Titles III and IV of the Energy Community Treaty. The need for flexible integration is by no means an argument against integration as such. In order to be successful and attractive, however, European law must be exported creatively. A simple "copy-paste" approach does not suffice for successful transplantation; the European law exported risks to remain debris in the receiving legal order.

⁴⁷ The EEA envisages the possibility of derogations. In the Energy Community, Article 24 of the Treaty stipulates: "For the implementation of this Title, the Energy Community shall adopt Measures adapting the *acquis communautaire* described in this Title, taking into account both the institutional framework of this Treaty and the specific situation of each of the Contracting Parties." The extension of the Republic of Moldova's deadline to unbundle its gas transmission system operator under the Third Package by the Ministerial Council in 2012 is the most relevant example for flexibility to date.

Access to the EU internal market

The EU internal market is an attractive target for investments as well as for goods, services and labour. Free trade and integration agreements pursue the objective of enabling mutual market access. The success of the EEA Agreement, for instance, depends on the EFTA countries' satisfaction with access to the internal market. The merits of market access are most direct for countries with strong export or investment companies. This is not necessarily the case in many ENP or enlargement countries.⁴⁸ Moreover, energy is a special case as cross-border trade is still not as much developed as it is in other sectors. And in the case of natural resources, the allure of access to the internal market may not be enough to offset the (perceived) threat to sovereignty through applying rules of transparency and non-discrimination.

That does not mean, however, that market access could not be or become a strong motive for acceding to an integration agreement such as the Energy Community. Market access is beneficial also for consumers. The advantages of gas reverse flows for Ukraine were already mentioned.⁴⁹ In electricity, Ukraine exports to the internal market from the so-called Burshtyn island at a profit. Pressure from the electricity business was one of the motives for the country joining the Energy Community. In the South Eastern Europe, so far only Turkey's investors have shown a real appetite for accessing the regional and the Union's markets. However, the country is currently prevented from joining the Energy Community for political reasons.

Security and solidarity

Integration does not only concern and benefit markets but also national security. This is most obvious in the strategically relevant energy sectors. The preamble to the Energy Community Treaty expresses the Parties' determination "to establish among the Parties an integrated market in natural gas and electricity, based on common interest and solidarity".⁵⁰ Integration and solidarity with the other parties to an integration agreement may help cushioning energy systems in crises, thus reducing

⁴⁸ The interest in market access may relate to access to the labour market and lifting visa requirements. The Association Agreement with Ukraine does not waive visa requirements. An amended Visa Facilitation Agreement of July 2012 addresses the issue.

⁴⁹ *Supra*, III. 1.

⁵⁰ This aspect was emphasized by Energy Commissioner Günther Oettinger, "An energy community for the future", Speech given in the European Parliament on 20 March 2014, http://europa.eu/rapid/press-release_SPEECH-14-238_en.htm?locale=en, retrieved 20 February 2014.

vulnerability and improving resilience. In energy, security of supply was one of the main motives for establishing an internal market in the first place. And crisis is no stranger to energy. The two gas disruptions in 2006 and 2009 which traumatized Europe both involved Ukraine. For the EU, integrating Ukraine in and through the Energy Community was a major achievement. For Ukraine, however, things are more complex, as it is also integrated closely with the gas system of a third country, Russia. Yet even under the Yanukovich regime Ukraine has explicitly appealed to European solidarity against actions of its Eastern neighbour. President Yanukovich had expressed his dissatisfaction with the Energy Community on account of the latter's purported failure to prevent the South Stream project, a serious threat to the viability of Ukraine's gas transport system.⁵¹ In fact, solidarity against South Stream was one of the main motives for Ukraine to join the Energy Community back in 2011. At the same time, other Contracting Parties have expressed a strong interest in realizing South Stream. What looks like a 'catch 22' is actually a misunderstanding: Yanukovich's understanding of solidarity was a purely diplomatic one whereas the concept of solidarity in both the European Union and in the Energy Community is inseparable from the concept of the rule of law. The Secretariat in fact had already reminded the Contracting Parties which concluded intergovernmental agreements with Russia on South Stream of their incompatibility with European energy law. Solidarity in this sense means treating every country and every project equal by the yardstick of compliance with a country's legal commitments.

Accession to the European Union

Article 49 TEU grants any European state the right to apply to become a member of the EU. The hope to join the European Union as a full member and to speed up that process makes accession candidates accept the rule of European law already before the date of accession. Preparing countries in South Eastern Europe for accession was one of the founding motives of the Energy Community. These countries are ready to take upon them the hardship of reforms as EU membership is their main and maybe only strategic policy option. However, this motive has eroded to some extent even in the Balkans. EU enlargement fatigue, the slowing-down of the accession process and the fading of hope that EU accession will rapidly improve the

⁵¹ http://www.energy-community.org/portal/page/portal/ENC_HOME/NEWS/News_Details?p_new_id=6821, retrieved 20 February 2014.

economic situation in these countries creates frustrations and resistance against carrying on with reforms.⁵²

The Eastern Partnership countries such as Ukraine have not been offered EU membership in concrete terms. The Association Agreement “is not about EU membership for Ukraine”.⁵³ The Ukrainian population and political elite have always been very conscious about the lack of a clear membership perspective. After the rejection of the Association Agreement, there are more voices in Europe who believe that the EU should change course. Commissioner Füle stated recently that “only a promise of future accession can change the region”.⁵⁴ And on 10 February 2014 the Council acknowledged “that this [the Association] agreement does not constitute the final goal in EU-Ukraine cooperation”. This was explicitly linked to Article 49 TFEU by the recent congress of the European People’s Party.⁵⁵ That is currently not the mainstream view within the European Union, let alone its formal position. However, the question of when and under which conditions to consider EU membership of ENP countries in more concrete terms is on the table and will require an answer. If EU accession turns out not to be possible, a well-designed multilateral integration agreement matching the needs and interests of the countries in question can be a valid second-best option. The case of the EEA/EFTA countries, having rejected EU membership on their own motion, shows that such alternatives can work well. A sectoral agreement such as the Energy Community, however, cannot replace EU accession and will have to satisfy additional interests of its members.

Financial support and attracting investment

Besides preparing for accession, the second key motive for founding an Energy Community back in 2005 was the attraction of investment and (private) investors, both through domestic reforms and integration of small markets. The interest in attracting investments is as strong as ever in the ENP countries. With the economic

⁵² Andrea Despot/Dušan Reljić/Günter Seufert, “Ten Years of Solitude - Turkey and the Western Balkans Require Practical Integration Measures to Bridge the Hiatus in the European Union Enlargement Process”, *SWP Comments*, 2012/C 16, May 2012.

⁵³ European Commission, “Myths about the EU-Ukrainian Association Agreement – Setting the facts straight”, *op.cit.*, p. 4. The preamble recognizes, however, that “Ukraine as a European country shares a common history and common values with the Member States of the European Union”.

⁵⁴ <http://euobserver.com/foreign/123055>, retrieved 20 February 2014. Others are more skeptical, for instance, Commissioner Olli Rehn in an interview with *Frankfurter Allgemeine Zeitung* of 7 April 2014.

⁵⁵ Emergency Resolution on Ukraine adopted by the EPP Congress, Dublin, 6-7 March 2014.

crisis still not over and implementation not advancing as fast as the commitments suggest, private investment did and does not come in the desired magnitude. Remedies are not obvious. In any event, seriously applying the rule of law, as a 'meta-principle' of the *acquis communautaire* including, *inter alia*, functional institutions such as courts and regulators, is the *sine qua non* for investment attraction. This may have not yet been fully understood and deserves better promotion. Still, it will not be sufficient. In the context of the Energy Community reform process, additional mechanisms to support the raising of the necessary funds for energy investments and mitigating risk are currently being discussed.

Public investment by international donor organizations such as the EBRD, EIB, World Bank or the European Union is not directly affected by the crisis. It usually comes with conditions which often make reference to full implementation of the *acquis communautaire*. Conditionality is never popular. In Ukraine, the former administration was frustrated when it realized that the EU and Western donors would indeed not invest in rehabilitating the gas system without the country being serious about reforms. Conditionality, however, is a two-edged sword: on the one hand, it links the 'carrot' of financial help with implementation of the rules. It is thus of equally big importance as the 'stick', enforcement. On the other hand, conditionality can be dangerous where countries consider having other options. The conditions Russia made in November 2013 seemed to be easier acceptable to Ukraine's *ancien régime*. We may conclude that conditioning financial support is indispensable for reforms to materialize but the conditions must be carefully chosen. In this respect, focusing on structural reforms may be more promising than the demand for drastic rises in energy prices.

The question of financial support is still in flux. While the German Foreign Minister stated that "the EU cannot enter into a competition of billions compared to what Russia can put at Ukraine's disposal",⁵⁶ the course of the events seems to change the attitude in the EU and international donors with regard to the short-term needs of a country on the verge of bankruptcy. The EU's recent assistance package consists of € 11 billion, of which the majority is loans from EBRD and EIB.⁵⁷ In the long term, however, investment must come from private sources, for which, in turn, reform and integration must path the way.

⁵⁶ German Foreign Minister Steinmeier, <http://euobserver.com/foreign/123078>, retrieved 20 February 2014.

⁵⁷ For details see <http://euukrainecoop.com/2014/04/14/rasbash-3/>.

Conclusions

Over the last decades, the EU has been silently expanding⁵⁸ through the export of its internal market laws. This process has run smoothly as far as multilateral agreements are concerned, especially with the EEA and the Energy Community. The latter, which in only a few years has developed into the principal policy instrument for organizing the EU's foreign energy relations, shows that the export of European law to ENP countries has a future. Further 'juridification' of external relations will also benefit the European Neighbourhood Policy.

Expansion through bilateral agreements, on the other hand, seems to have hit rock-bottom in EU relations as diverse as Russia and Switzerland. But it was the violent case of Ukraine that turned the spotlight on this expansion process and the unresolved questions underlying it. Given that neighborhood policy is not the EU's exclusive backyard anymore, and that neighbouring countries do have other options, the content and circumstances of the European offer matter.

The European Union should, firstly, build on and share its own experience in integrating the continent under one common market based on common rules and institutions. Where accession is not an (immediate) option, the Union should not be afraid of creating communities governed by fair rules and effective procedures. To be credible, the Union should commit to such communities also legally by joining as an equal partner. This commitment has been one of the success factors of the Energy Community.

Secondly, an attractive offer must create true win-win situations, which requires that the partner country has a vital and continuous interest in implementing the *acquis communautaire*. In doing so, we have to make business, civil societies and consumers our allies and help them also satisfying their interests, such as increased transparency and effective judicial protection. The failure to include civil society in the discussions of the Association Agreement was one element that triggered the Euro-Maidan revolution and everything that followed. Values such as transparency, reliability and the rule of law are Europe's 'unique selling point' in the competition for the most attractive economic and political governance model.

⁵⁸ Alvin Pool, "The Silent Enlargement", *EU Reporter*, Spring 2009, pp. 24-25.

Thirdly, it must be recalled that in order to be successful, the 'transplantation' of European law requires certain foundations in terms of legal and cultural traditions, including the independence and effectiveness of institutions, which we cannot take for granted in third countries other than the EFTA States. This fundamental challenge is often overlooked. As Alan Riley recently observed, addressing it is essential in order to make European law export a success.⁵⁹

Fourthly, exporting European rules through integration agreements should not follow a simplistic mechanism of 'one-size-fits-all' but should leave room for flexibility. Flexibility in integration agreements has two main dimensions: flexibility in adapting the EU rules taken over by the participating third countries, and flexibility in designing genuine rules and institutions for all parties, including the European Union. In the best case, this creates laboratories also for the further development of European policy and legislation. Flexibility and homogeneity must be well-balanced. The European Union, its rules and institutions should remain the point of reference also in an expanded internal market. This requires "creative homogeneity" among the institutions involved.⁶⁰

Finally, the European neighbourhood has become larger. In times of globalization, it cannot be determined solely on the basis of geography any more. Under the condition that third countries share our core values, extending the internal market through integration agreements means continuing the European story and should not be ruled out for individual countries or regions. The Energy Community proves that integration can take place in one sector, even if as many vested interests as in energy are involved. Integration has positive knock-on effects on stability and peace. Under the condition that overly controversial issues such as natural resource governance are excluded (which in energy basically leaves the electricity sector or cross-cutting policies such as energy efficiency), even countries which are currently perceived as difficult neighbours may in the future become partners in a multilateral integration agreement.⁶¹

⁵⁹ Alan Riley, "Deploying the Energy Incentive: Reinforcing EU Integration in South-East Europe", *CEPS Policy Brief*, no. 268, Brussels, 8 July 2013.

⁶⁰ A term coined by the former judge at the European Court of Justice Christiaan Timmermans (ed.), *Creative Homogeneity, Liber Amicorum in honour of Sven Norberg*, Brussels 2006, pp. 471 ff.

⁶¹ The Foreign Minister of Austria, Sebastian Kurz, recently discussed the idea of integrating Russia through a Free Trade Area, see *Der Standard* of 7 April 2014.

Summing up, the export of European internal market law and governance constitutes still the best available instrument to achieve market reforms in partner countries and integration with the European Union. It needs to match the interests of the partner countries which in turn calls for the European Union to define its own strategic interests, the core values and principles we are insisting on as well as a discussion on what we are ready to offer in terms of, for instance, accession or financial support. This will require a thorough and open internal debate. The recent events in Ukraine have made it very clear that the export of European rules is not a one-way street. As the recent proposal by the Polish Prime Minister to create an Energy Union shows,⁶² these events are even capable of triggering a renaissance of visionary integration concepts within the EU-28, something hard to imagine only a few months ago. The Energy Community, arguably the EU's most seminal vehicle for the export of EU law today, already establishes an energy union *avant la lettre*.⁶³ It is a true pan-European union in which the EU and its Member States are not alone any longer.

⁶² Donald Tusk, "A united Europe can end Russia's energy stranglehold", Financial Times of 21 April 2014.

⁶³ In particular if the potential of Title IV of the Treaty was fully tapped and/or further developed.

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